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UNCLAS SECTION 01 OF 04 TEGUCIGALPA 002034

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STATE PASS AID FOR LAC/CEN  
STATE PASS USTR FOR ANDREA GASH DURKIN  
TREASURY FOR C. KUSHLIS  
DOL FOR ILAB

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SUBJECT: IMF AGREEMENT HINGING ON SALARY LAW

REF: TEGUCIGALPA 1581 AND PREVIOUS

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SUMMARY  
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11. (SBU) The imminent GOH submission to Congress of a new government salary bill (substituting the broader Civil Service Framework bill) is dominating the political debate in Honduras this week. President Maduro and his team have appeared on the airwaves and taken out ads in the papers defending the need to address the burgeoning public sector wage bill, and in particular the legislatively-mandated increases in teacher and medical employees' salaries. The World Bank will sponsor a two-day roundtable entitled the National Dialogue, on August 28-29, in an effort to forge a national fiscal pact that will facilitate the adoption of the legislation by the National Congress, when introduced next week. The IMF and GOH continue intensive discussions on the details needed to be included in the law to lay the basis for an IMF agreement, and continue to have strong differences. The leftist Popular Block held demonstrations in Tegucigalpa and temporarily blockaded the major routes into the city August 26 to voice its membership's strong opposition to the measures. This may prove to be the endgame for the IMF negotiation. End Summary.

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The Needs: A Salary Law and Wage Bill Reductions  
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12. (SBU) Improved control of the burgeoning public sector wage bill has now become the critical issue in Honduras' troubled negotiations with the International Monetary Fund on a new Poverty Reduction and Growth Facility (PRGF) program. Government wages rose by 140 percent in nominal terms between 1998 and 2002, accounting for 60 percent of the growth in public spending in that period. Government wages have reached an unsustainable level of ten percent of GDP. Although other issues (such as the adequacy of recent tax measures and implementation of financial sector reform) remain on the table and will need to be addressed in the context of a three-year PRGF program, Fund staff have made clear to the government that the following measures are minimum requirements for return of a mission and negotiation of the letter of intent: (1) legislation which provides the executive branch of government control over public sector wage policy, and (2) reductions in the wage bill as a percent of GDP of 0.5 percent in both 2004 and in 2005, which in turn implies a reduction of the planned wage increases for teachers. The IMF had earlier been pushing for a 1.0 percent of GDP reduction in the wage bill in both 2004 and 2005, but has agreed to allow the GOH to fill the budget hole with additional foreign donations.

13. (SBU) The IMF and GOH have agreed that negotiation of a fiscal pact among different sectors of society would be the best way to develop the elusive consensus on needed changes in Honduran law and policy. The World Bank office here is assisting in this process by bringing in Colombian economist and former Finance Minister Roberto Junguigo to moderate a two-day roundtable entitled the National Dialogue, on August 28-29. Approximately 60 participants, from government, Congress, private sector, public sector unions and civil society, will participate in the roundtable. One of the hoped-for outcomes of this meeting will be a commitment on the control of public sector salaries.

14. (SBU) Because of the political controversy that has arisen this summer as a result of the discussion over a draft Civil Service law, the GOH has decided to divide the bill in two. The GOH now plans to introduce a shorter bill (during the first week of September) called the Law on Salary Equity that only covers the wage policy for the government employees. The reforms that would establish a permanent and professional civil service will be submitted at a later date. To meet the targets of reducing the public sector wage bill as percent of GDP in 2004 and 2005, the GOH has proposed a law that would

include the spreading out of planned teacher increases for 2004 and 2005 over the four-year period of 2004-2007.

15. (SBU) An IMF mission, visiting Honduras in late July, saw a draft of the bill and gave its blessing with one important exception. The Fund staff objected to the provision stating that teachers will not be subject to the integrated salary (one salary rate, without additional built-in raises for years of service, teacher certification and other collateral allowances) until 2008; this matches the planned, new period for the teacher agreement. This draft government salary bill has been under intensive, but private, discussion since that time. The IMF resident rep. continues to express the Fund's concerns that the lack of reduction of the collateral allowances during the transition period will undercut the GOH's efforts to control the wage bill in the next few years and reduce the budget deficit to manageable levels. This is going to be a politically difficult proposition; teachers are already striking and marching against an earlier proposed reform to the civil service law that has much more modest impact on their compensation packages.

16. (SBU) The GOH, working closely with the World Bank, is trying to square the circle by identifying other ways to reach the IMF's fiscal goals. They hope, for example, that the fiscal pact will include a two-year wage freeze for doctors and nurses. They may also try to focus on quiet incremental changes to the two most costly collateral built-in salary increases in the teachers' compensation statute. For example, one idea forwarded is that the "quincenio" provision, which provides a twenty percent increase in salary for every five years of service, might not be provided to new teachers. Another idea, that the "licenciatura", which provides a seventy percent increase for teachers who receive their teacher certification, be divided between a 20 percent increase in pay and a 50 percent contribution to pension funds.

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Appealing for Congressional and Public Support  
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17. (SBU) Congressional leaders have made it clear, up to now, that any proposed reforms to medical and teacher compensation (implying changes to the special statutes that govern these public sector groups) would be dead on arrival unless there is a consensus from all sides on the bill, which has forced the government into problematic negotiations with the unions. The teacher unions have refused, up to now, to reopen negotiations on the 2002 agreement (which by the way, were only accepted by the primary school teacher unions and not the secondary teachers, although the GOH imposed these terms on the secondary teachers).

18. (SBU) Under heavy pressure from the international community for more leadership and political courage, Maduro and his team have started a full court (although at times clumsy) press to appeal for public support. Maduro spoke to the nation on August 24 on the need to control the public sector wages of certain privileged groups for the sake of economic reactivation.

19. (SBU) Minister of the Presidency Luis Cosenza, Central Bank President Maria Elena Mondragon, and Finance Minister Arturo Alvarado spoke the next evening providing the technical arguments for the need to control the wage bill. The three focused on the fact that these privileged groups are receiving large annual increases while others have had their wages frozen, and all at the expense of provision of public services and spending on poverty reduction. Although they did acknowledge that wage policy control was vital to reaching an agreement with the IMF, the GOH team has tried to make it clear that the underlying issue is the unsustainable budget deficits.

10. (SBU) The politics of this legislation has been complicated all along, and has been a clear example of Maduro's weak political position and limited political skills of his technocratic administration. Maduro is the first democratically elected president whose party has not had a majority in the National Congress, making his administration dependent on support from small parties. The Christian Democrats left a formal coalition in July (citing, among other reasons, the GOH's lack of openness about the IMF negotiations and the civil service law deliberations). The GOH now needs to pick up votes from the opposition Liberal Party and try to keep members of Maduro's own Nationalist party, from straying. Politically, neither side can afford to be seen as catering to the demands of the IMF over the interests of Honduran workers. On the other hand, none of the political parties can afford the economic mess that will result if an agreement with the Fund is not reached (and the structural deficits are not addressed). As political leaders around the country are weighing their chances of gaining a Presidential nomination, these calculations become difficult.

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Popular Block and Teachers Take to the Street  
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11. (SBU) Teacher's union and other opponents of any change in the civil service law that would negatively affect their pay and benefits have denounced the proposed changes as "fascist", despite the fact that no one has yet seen a draft bill detailing the proposed changes. The fact that the IMF is pressing for such changes makes it easier for reform opponents to protest proposed changes as, in their view, globalist, neoliberal economics being imposed via the GOH to the detriment of Honduran sovereignty and the Honduran people.

12. (U) The leftist Popular Block, a loosely knit umbrella organization that encompasses many public sector unions, leftist NGOs, and other groups, led a series of significant protests in and around Tegucigalpa August 26 demonstrating against the proposed civil service law, a new water law, as well as the usual anti-globalization targets such as CAFTA. Protesters initially blocked the four major roads in and out of Tegucigalpa, the roads to Choluteca, Danli, Olancho, and San Pedro Sula and the North Coast. The demonstrators, while peaceful, were armed with rocks, sticks, ropes, boards with nails, and gasoline, and caused huge traffic problems in and out of the city. Protesters then marched to the center of Tegucigalpa for demonstrations in front of Congress. Although peaceful when witnessed by PolOffs, some protesters later became violent, throwing rocks and Molotov cocktails at congressional buildings and confronting the police. Post believes it is likely that the Popular Block will organize more such demonstrations if Congress takes up a wage bill.

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Comment: Why the Urgency?  
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13. (SBU) The negotiations with the GOH have been dragging on since Maduro took office in January 2002. The last 19 months have been marked by a series of austerity and tax measures that have been controversial and politically costly, but in fact have had only moderate impact on the government's budget woes. In addition, there have been some key junctures in which the Fund's position was ignored (i.e. the unsustainable cost of the 2002 agreement with the teachers) or misunderstood (i.e. the Agricultural Finance law). The Congress, during this period, has continued to water down fiscal package legislation and try to slip in new budget busting measures without care. The IMF mission has thus become increasingly skeptical about GOH commitments. The GOH, after getting two fiscal packages through in two years and cutting discretionary spending to the bone, feels strongly that the IMF has been unfair and unrealistic about political realities. One could make the argument that the latest burp in the negotiations is just more of the same.

14. (SBU) However, there are two new changes in the environment that justify the argument that it is now or never for a Honduran IMF agreement. First, the GOH has now basically exhausted the USD 170 million dollars previously held by Hondutel (the Honduran state-owned telephone company). These funds have been used to fund budget deficits and cash requirements for state takeovers of failed banks last year. From now on, budget deficits are going to need to be covered by foreign donations and concessional loans from international financial institutions. Many of these sources of funds are tied to having an IMF agreement. At the same time, deferrals on foreign official debt are starting to expire, which will increase the demands on the Honduran treasury. The USG, for example, has notified the GOH of a series of overdue payments on old DOD debt that must be paid in order to avoid Brooke amendment sanctions. July and September payments have now been received, but more payments are due in October, and throughout 2004.

15. (SBU) If the GOH is not able to reach agreement with the IMF quickly, President Maduro may be tempted to begin printing money to cover expenses or to forego the foreign debt payments and let the Brooke sanctions take effect. Maduro badly needs to move beyond this issue in order to begin spending time and money on the strengthening of public security, education and health programs, and delivering on his campaign promises of poverty reduction and economic growth.

16. (SBU) It is beginning to look likely that the GOH will submit to Congress a government salary bill that does not fully meet IMF requirements, partially with World Bank blessing. If that is the case, and the Congress adopts the legislation (itself a big if), the Fund staff will have a big decision to make on whether a half glass is better than none at all. End Comment.

PALMER